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IN THE

Supreme Court of the United States

October Term, 1975
No. 75-573

RICHARD L. ZWEIG, *et al.*,

Petitioners,

vs.

THE HEARST CORPORATION,

Respondent.

JERRY GREENFIELD, *et al.*,

Petitioners,

vs.

THE HEARST CORPORATION,

Respondent.

Brief in Opposition to Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

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Brief in Opposition to Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

Respondent The Hearst Corporation hereby opposes the Petition for a Writ of Certiorari filed by Petitioners Richard L. Zweig, Muriel Bruno and Jerry Greenfield and respectfully urges that it be denied.

Opinions Below.

The opinion of the Court of Appeals, which has not been reported as yet, is set forth in Appendix A to the Petition.

Counterstatement of the Case.

Alex N. Campbell was employed to write daily financial columns in the Los Angeles Herald Examiner, a daily newspaper published by The Hearst Corporation. Petitioner is attempting to invoke liability upon The Hearst Corporation because Campbell purchased stock in a company about which he had written an article. Although Respondent does not controvert Petitioner's statement of the case, additional facts are necessary to review the question here presented.

In examining the issue of whether The Hearst Corporation acted in good faith, the Ninth Circuit considered these facts:

1. Campbell had worked for the Los Angeles Herald Examiner for thirty (30) years.
2. Campbell chose his own subjects for his articles without suggestion from the Los Angeles Herald Examiner.
3. The Los Angeles Herald Examiner was unaware of any financial interest Campbell may have had in American Systems, Inc.
4. The Los Angeles Herald Examiner never investigates the financial affairs of its employees unless for cause.
5. Prior to the publication of the article regarding American Systems, Inc., the Los Angeles Herald Examiner had never received any complaints concerning any article written by Campbell.
6. The Los Angeles Herald Examiner expected Campbell as well as all its reporters, to prepare articles factually and truthfully, and Donald Goodenow, Managing Editor of the Los Angeles Herald Examiner and Campbell's Supervisor, had discussed this expectation with Campbell prior to the publication of the article concerning American Systems, Inc.

7. The Los Angeles Herald Examiner was not in the securities business.
8. The Los Angeles Herald Examiner did not at any relevant time deal in American Systems' stock.
9. The Los Angeles Herald Examiner had no financial interest in American Systems, Inc.
10. The Los Angeles Herald Examiner relied on the integrity of Campbell, a thirty (30) year employee in the Financial Department, about whom no complaint had ever been made.
11. Immediately upon notification of Campbell's ownership of stock in American Systems, Inc., The Los Angeles Herald Examiner suspended publication of Campbell's articles, conducted an investigation, and thereafter reinstituted publication of Campbell's articles only after entering into an agreement that Campbell would not write about a company in which he had a financial interest and, further, would only write about companies listed on one of the two major stock exchanges.

Introduction.

The Petitioners originally instituted their actions against not only Respondent and Alex Campbell but also officers and directors of American Systems, Inc. The Hearst Corporation removed itself from the litigation by obtaining a summary judgment which was af-

firmed on appeal. As to the remaining Defendants and the underlying lawsuits, the District Court in the Greenfield case has denied class status to the action and has dismissed the lawsuit for Plaintiff's failure to prosecute. The District Court in the Zweig case has granted Campbell's motion for dismissal.

Respondent in seeking a denial of the Petition, makes the following contentions:

1. The facts of the instant action are so unusual and unique that they should not form the basis for a definitive rule of law in the securities field.
2. There is not a substantial disparity of opinion among the Circuit Courts of Appeals on the primary issue herein.
3. The primary issue here involved has so rarely confronted the Circuit Courts that it cannot be said to be an important question of federal law.
4. The application of the good faith defense in the subject case is appropriate in the unique factual setting and is not in conflict with any principle espoused by any other circuit.

The Decision of the Court of Appeals Is Based Upon the Complex, Unusual and Unique Facts of the Instant Case Which Is an Inappropriate Context for the Formulation of a Definitive Rule of Law in the Securities Field.

Respondent contends that the facts of the instant case are *sui generis* and that it would be ill-advised and inappropriate to use this factual context as a basis for developing a standard of liability in the securities field. As the Ninth Circuit noted in its decision:

> "Our research has not uncovered, and very competent and thorough counsel have not drawn our attention to, any case either on four squares with this case or offering controlling precedent."

The Ninth Circuit, having found the myriad of cases of the securities field to be of no assistance, correctly espoused a decision based on the facts intrinsic to the case before it. The propriety of limiting the scope of its decision because of the nature of the case before it rather than attempting to make an expansive rule of law is further supported by the position taken by the Second Circuit in *Securities and Exchange Commission v. Management Dynamics Inc.* 515 F.2d 801 (2nd Cir. 1975) wherein it stated at page 813:

> "We need not decide today whether the entire corpus of agency law is to be imported into the securities acts for all purposes. We hold only that, in the circumstances of this case, the SEC in this enforcement action was entitled to an injunction. . . . We stress again, however, that we intimate no view as to other cases which may involve a lesser employee, actions for damages, other agency principles, or respondeat superior, which may be broader than the apparent authority involved here. Such cases may involve entirely different policy considerations that are best consigned to future resolution."

Research has uncovered no case considering the potential liability of a newspaper of general circulation for a securities act violation in connection with the publication of news articles. A precedential decision on such a question would appear of little value to the lower courts who are constantly confronted with cases involving broker-dealers, and not others only peripherally involved in securities regulation.

There Is No Substantial Disparity Among the Circuit Courts of Appeals as to the Standard of Vicarious Liability.

An examination of the decisions in the Circuit Courts of Appeals as to employers' liability for their employees' violations of the Securities Exchange Act of 1934 does not support Petitioners' contention that there is an irreconcilable split among the Circuits. The leading case for the proposition that Section 20 (the so-called "controlling person" provision) of the 1934 Act exclusively determines the liability of an employer is *Kamen and Co. v. Paul H. Aschkar and Company,* 382 F.2d 689 (9th Cir. 1967), *cert. granted,* 390 U.S. 942, 88 S.Ct. 1021, 19 L.Ed.2d 1129, *cert. denied,* 393 U.S. 801, 89 S.Ct. 401, 21 L.Ed.2d 85 (1968). The Ninth Circuit has abided by that decision in the subsequent cases of *Hecht v. Harris, Upham & Co.,* 430 F.2d 1202 (9th Cir. 1970) and *Douglass v. Glenn E. Hinton Investments Inc.,* 440 F.2d 912 (9th Cir. 1971).

The Second Circuit has considered whether the principle of *respondeat superior* should be used to determine an employer's liability for its employees' violations of the 1934 Act, and has rejected the application of this common law theory of liability, holding that the only standard of liability is the "controlling person" section of the 1934 Act. *Lanza v. Drexel & Co.,* 479 F.2d 1277 (2nd Cir. 1973) and *Gordon v. Burr,* 506 F.2d 1080 (2nd Cir. 1974). It is true, as Petitioners contend, that the Second Circuit in *SEC v. Management Dynamics, supra,* upheld an injunction against a broker-dealer, based upon the application of agency principles.

However, the court specifically stated that its decision was limited to the facts of that particular case and to the remedy sought, stating at page 813:

> "We need not decide today whether the entire corpus of agency law is to be imported into the securities acts for all purposes. We hold only that, in the circumstances of this case, the SEC in this enforcement action was entitled to an injunction against Carno because of Nadino's trading activity. . . . We stress again, however, that we intimate no view as to other cases which may involve lesser employees, actions for damages, other agency principles, or respondeat superior, which may be broader than the apparent authority involved here. Such cases may involve entirely different policy considerations that are best consigned to future resolution."

The Third Circuit, in accord with the Ninth Circuit, recently held that the "controlling person" provision of the 1934 Act is the standard of liability for employers, and not *respondeat superior.* In *Rochez Brothers Inc. v. Rhoades* (September 29, 1975) CCH ¶95,313, the Court examined the legislative history of the 1934 Act and concluded that ". . . the principles of agency, *i.e., respondeat superior,* are inappropriate to impose secondary liability in a securities violation case." It further held that liability cannot be found under Section 20(a) unless it can be shown that the defendant-employer was a culpable participant in the acts constituting the fraud.

In the Fourth Circuit, the only decision concerning the vicarious liability of an employer for a violation

of a federal securities law is *Johns Hopkins University v. Hutton,* 422 F.2d 1124 (4th Cir. 1970). In that case, the court was confronted with a violation of Section 17a of the 1933 Act. It held that the doctrine of *respondeat superior* should be applied in the particular case despite the "controlling person" section of the 1933 Act. Since the court in *Johns Hopkins* was not presented with a violation of the Securities Act of 1934, it has not decided the issue here presented. Reconciliation of the decision in *Johns Hopkins* with the position of Respondent herein is found in the fact that the "controlling person" provision of the 1933 Act specifically limits its application to persons liable under Sections 77K or 77L, which do not involve Section 17(a) of the 1933 Act. The comparable provision, Section 20(a) of the 1934 Act, does not have this limitation. Further, the court in *Johns Hopkins* relied upon the legislative history of the 1933 Act in reaching the decision therein. Obviously, the court did not examine the legislative history of the 1934 Act and its "controlling person" provision which, according to the courts in *Rochez Brothers Inc. v. Rhoades, supra, Lanza v. Drexel, supra, SEC v. Lum's Inc.,* 365 F.Supp. 1046 (S.D.N.Y. 1973), and *Gordon v. Burr, supra,* clearly indicates that Section 20 of the 1934 Act replaces common law theories of vicarious liability and that the application of principles of agency would be inconsistent with the legislative history of the 1934 Act.

The Sixth Circuit in *Armstrong, Jones and Co. v. Securities and Exchange Commission,* 421 F.2d 359 (1970), *cert. denied,* 398 U.S. 948, 90 S.Ct. 2172, 26 L.Ed.2d 543 (1970) was confronted with a situation wherein certain employees of a broker-dealer violated sections of the 1934 Act prohibiting the use of fraudulent statements in connection with the sale of any securities. The Commission had sanctioned the broker-dealer for the willful acts of its employees. Relying on an administrative decision of the SEC, the Sixth Circuit agreed with the position of the Commission that a broker-dealer may be sanctioned for the willful violation by its employees under the doctrine of *respondeat superior.* The Sixth Circuit did not discuss the "controlling person" provision of the 1934 Act, nor did it discuss any legislative history of the 1934 Act, nor did it comment on any decision of any other Circuit regarding the question of "*respondeat superior* v. controlling person" under the 1934 Act. These omissions would indicate that the Sixth Circuit restricted its decision to the situation before it and did not attempt to establish a rule of law in its Circuit on the question here involved.

The Seventh Circuit, in *Securities and Exchange Commission v. First Securities Company of Chicago,* 463 F.2d 981 (7th Cir. 1972), *cert. denied,* 409 U.S. 880, 93 S.Ct. 85, 34 L.Ed.2d 134 (1972), considered claims of fraudulent activity founded upon two separate causes of action, one based upon the common law liability and the other based upon violations of the Securities Act of 1934. As to the securities law violation, the Court specifically held that Section 20(a) of the 1934 Act provided for the exclusive remedy of the claimants in a Section 10(b) action. The Court found that Nay, as the President and employee of First Securities, was in fact controlled by First Securities within the meaning of Section 20(a), and therefore vicarious liability was imposed by that Section. For the same result see also *Sennot v. Rodman and Renshaw,* 474 F.2d 32 (7th

Cir. 1973), *cert. denied,* 414 U.S. 926, 94 S.Ct. 224, 38 L.Ed.2d 160 (1973). Subsequently, the Seventh Circuit, in *Fey v. Walston and Company Inc.,* 493 F.2d 1036 (7th Cir. 1974), considered the liability of an employer and based such liability on a theory of *respondeat superior.* However, the Court cited *SEC v. First Securities Company* in support of its position which would appear to be entirely inconsistent with that prior decision. Due to the conflicting nature of these two circuit cases, it does not appear that the Seventh Circuit has made a final determination as to the standard of liability of employers for employees' violations of the Securities Exchange Act of 1934.

The Eighth Circuit in *Myzel v. Fields,* 386 F.2d 718 (8th Cir. 1967), *cert. denied,* 390 U.S. 951 (1968), considered the liability of an employer under the 1934 Act, and, as the court in *Rochez v. Rhoades, supra,* noted, indicated that liability for such securities act violations was governed by Section 20(a) and not by agency theories.

The remaining Circuit which has examined Section 20(a) is the Tenth Circuit in the case of *Richardson v. MacArthur* 451 F.2d 35 (10th Cir. 1971). In that case, the Court held a life insurance company liable pursuant to Section 20(a) of the Securities Exchange Act of 1934 for the acts of one MacArthur who was selected by the company to develop the life insurance business in California. MacArthur's activities and authority, reviewed in detail by the Court, seemed sufficient to establish the principal-agent relationship. Notwithstanding this agency nexus, the Court relied on Section 20(a) to impose vicarious liability.

The Infrequency of Circuit Court Decisions Belies Petitioners' Contention That the Issue Involved Herein Is One of Considerable National Importance.

A review of the Circuit Court decisions since the enactment of the Securities Exchange Act in 1934 reveals that the issue here involved has been considered on not more than fourteen occasions. This fact becomes more significant when considering the volume of litigation that has been generated by the 1934 Act.

One might well expect that if the debate on this issue had assumed the proportions suggested by Petitioners, more cases would have arisen and a significant divergence of opinion could be found in reported cases. In addition, the resolution of this issue in the context in which it is here presented would seemingly be of little precedential value because of the uniqueness of the facts and the presumed limited applicability of the decision based on these facts. Therefore, before adopting a comprehensive rule of law for liability of employers, the Circuit Courts of Appeals should be given additional time, especially in broker-dealer cases, to examine and determine the ramifications of holding an employer liable for the acts of its employees.

Petitioner Points to No Conflict Among the Circuits or Question of National Importance With Respect to the Circuit Court of Appeals' Application of the Good Faith Defense.

In their brief, Petitioners present two questions concerning the defense of good faith asserted by The Hearst Corporation. However, Petitioners' brief is devoid of any authorities indicating that the Ninth Circuit has taken a position in conflict with another Circuit or that the Ninth Circuit inappropriately applied

the defense of good faith. The underlying nature of Petitioners' attack on this point consists of an attack on the factual findings of the Ninth Circuit in this particular case. The facts relied on by the Court below clearly support the application of the good faith defense and render it unnecessary to articulate a definitive rule for the application of that defense for all cases. It is respectfully suggested that it would be premature for this Court to enunciate a complete statement with respect to what constitutes the good faith defense before the circuits review a sufficient quantum of such disputes that founding principles and policies can be carefully identified and scrutinized.

Conclusion.

Respondent respectfully submits that the Petition for Writ of Certiorari be denied as there exists no substantial conflict in the decisions of the Circuit Courts of appeals on the "controlling person v. *respondeat superior*" issue of vicarious liability under the Securities Exchange Act of 1934. Further, the nature of the parties and the uniqueness of the facts herein suggest neither an issue of compelling national interest or a need for establishing a universal principle of law.

Respectfully submitted,

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